No. 91-605

In the Supreme Court of the United States

OCTOBER TERM, 1991

DANNY O. CHERIF, ET AL., PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

KENNETH W. STARR
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 514-2217

JAMES R. DOTY
General Counsel

PAUL GONSON
Solicitor

JACOB H. STILLMAN
Associate General Counsel

JOSEPH A. FRANCO
Special Counsel

RANDALL W. QUINN
Senior Counsel

JUDITH R. STARR
Attorney
Securities and Exchange Commission
Washington, D.C. 20549

QUESTIONS PRESENTED

1. Whether petitioner Cherif violated Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. 240.10b-5, by trading securities on material nonpublic information that petitioner had misappropriated from his former employer.

2. Whether the court of appeals had jurisdiction to keep in effect a preliminary injunction against petitioner Sanchou so that the district court could determine the nature of his interest in certain assets frozen by the injunction.

3. Whether petitioner Sanchou was properly served with process in Tunisia.

4. Whether petitioner Sanchou's constitutional rights were violated by the district court's refusal to modify the preliminary injunction's freeze of domestic assets to permit Sanchou to use funds whose ownership was disputed to pay attorneys' fees in this civil action.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases:

Cases—Continued: Page

Constitution, statutes, regulations and rules:

Miscellaneous: Page

In the Supreme Court of the United States

OCTOBER TERM, 1991

No. 91-605

DANNY O. CHERIF, ET AL., PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 5-28) is reported at 933 F.2d 403. The orders of the district court (Pet. App. 29-48; App., *infra*, 1a-8a) are unreported.

JURISDICTION

The judgment of the court of appeals was entered on April 29, 1991. The petitions for rehearing were denied on June 7, 1991. Pet. App. 1-4. The petition for a writ of certiorari was filed on September 5, 1991.[1] The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

---

[1] The original petition was docketed on September 5, 1991, but failed to conform with the Rules of the Court. A conforming petition was filed on October 9, 1991.

STATEMENT

1. Petitioner Cherif was employed by The First National Bank of Chicago (First Chicago) from October 1979 until December 1987, when he lost his position because of an internal reorganization. Pet. App. 6. First Chicago required its employees, including Cherif, to adhere to an "integrity policy" that restricted the employees' use and disclosure of information regarding First Chicago's customers. *Id.* at 7. In addition, the policy prohibited employees from, among other things, "utiliz[ing] for personal gain" any "confidential information" about First Chicago, including information regarding "trade secrets" or "internal policies." *Ibid.*; see also SEC C.A. Supp. App. 33.

After-hours access to the First Chicago building required the use of a magnetic identification card. Instead of surrendering his card at the conclusion of his employment, Cherif kept it and used a ruse to keep the card activated. A memorandum, bearing the forged signature of one of the bank's senior vice presidents, was sent to the bank's data-entry department, falsely stating that Cherif was working part-time for the bank on a special project and that Cherif's identification card should remain active. Using the card, Cherif was able to enter the First Chicago Building on nights and weekends for more than a year after leaving his employment. Although Cherif did not know it, his entries and departures were recorded by the building's security system. Pet. App. 6-7.

Shortly after his employment ended, Cherif established two securities brokerage accounts, one in his own name and the other in the name of petitioner Sanchou, his cousin who resided in Tunisia. The Sanchou brokerage account was opened with approxi-

mately $100,000. The source of those funds was a United States bank account in Sanchou's name, over which Cherif exercised control. Cherif was authorized to trade securities as Sanchou's agent, directed trading in the account opened in Sanchou's name, and received the account statements. Pet. App. 7-8.

First Chicago has a Specialized Finance Department that evaluates bank financing for its customers' extraordinary business transactions such as tender offers and leveraged buyouts. That department possesses confidential, nonpublic information with respect to those transactions. After some of his covert visits to the bank, Cherif used the two brokerage accounts he had opened to purchase the shares of companies that were the subject of proposed transactions about which the Specialized Finance Department possessed confidential information. Cherif's trading generated $247,000 in profits, of which approximately $93,000 was obtained through trading in the account in his own name and $154,000 in the Sanchou account. After Cherif's scheme was revealed to authorities by a confederate, the Federal Bureau of Investigation taped a conversation between Cherif and the confederate in which Cherif admitted his role in the scheme.[2] Pet. App. 7-8.

2. The Securities and Exchange Commission (SEC) filed an action against Cherif and Sanchou, alleging that Cherif violated Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act), 15 U.S.C. 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. 240.10b-5, and Section 14(e) of the Exchange Act, 15

---

[2] In the conversation, Cherif stated: "I'm the one that did it all." He added: "[I]f they find that I have an active ID * * * I'm probably screwed." Pet. App. 19; see also SEC C.A. Supp. App. 88, 92.

U.S.C. 78n(e), and Rule 14e-3 thereunder, 17 C.F.R. 240.14e-3. Sanchou was not alleged to have violated the federal securities laws, but was named as a defendant in order to recover the illegal profits obtained by Cherif in the Sanchou account and certain property of Cherif's held in Sanchou's name. Pet. App. 5, 8, 21.

Upon application of the Commission, the district court entered an ex parte temporary restraining order (TRO) to enjoin further violations of the securities laws by Cherif, to restrain Cherif and Sanchou from dissipating assets, and to require each of them to provide an accounting. Pet. App. 30-40. The court also authorized service on Sanchou in Tunisia by international express mail. *Id.* at 39. Thereafter, Sanchou was served by express mail and by a Tunisian court official in Tunis. App., *infra*, 2a. The day after the TRO issued, Sanchou unsuccessfully attempted to have the funds in the frozen accounts wired overseas. Pet. App. 23.

The district court held a preliminary injunction hearing shortly after entering the TRO. Cherif consented to an extension of the TRO to permit discovery to go forward. Sanchou neither appeared at the preliminary injunction hearing nor filed any response to the Commission's motion for preliminary injunction. Accordingly, the district court entered a preliminary injunction against Sanchou on the basis of his default, barring Sanchou from transferring or disposing of assets held in his name or under his control.[3] The

[3] The Commission agreed with Sanchou that the freeze would not apply to Sanchou's assets outside the United States. The frozen assets in the United States consist of approximately $250,000 in bank and brokerage accounts over which Cherif exercised control. SEC C.A. Br. 14 n.6, 49.

court also ordered Sanchou to provide the Commission with an accounting and prohibited Sanchou from destroying documents relating to the action. Sanchou failed to provide an accounting. Pet. App. 9; App., *infra*, 2a. Almost two months later, Sanchou moved to modify the preliminary injunction to allow him to use frozen funds to pay legal fees in connection with this action, and subsequently moved to vacate the preliminary injunction for lack of jurisdiction. The district court denied those motions. Pet. App. 9, 44.

After discovery, the district court entered a preliminary injunction against Cherif. In entering the injunction, the court found that the Commission had made an "overwhelming *prima facie*" showing that Cherif violated Sections 10(b) and 14(e) of the Exchange Act and Rules 10b-5 and 14e-3. Pet. App. 43.

3. Cherif and Sanchou appealed from the preliminary injunction and the district court's refusal to modify or vacate it. As to Cherif, the court of appeals affirmed the injunction in all respects, holding that the district court did not abuse its discretion in granting relief based on the violations alleged of Section 10(b) and Rule 10b-5. The court concluded that the SEC's complaint had properly relied on the misappropriation theory of insider trading. Pet. App. 10-15. In adopting the misappropriation theory, the court agreed with all of the courts of appeals that have addressed the validity of that theory. *Id.* at 15.

The court of appeals also rejected Cherif's argument that his conduct in obtaining inside information did not breach a fiduciary duty to First Chicago because "his employment with First Chicago ended before he stole and traded upon inside information." Pet. App. 16. The court stated that Cherif violated "a continuing duty to his former employer" by using

property and information acquired during his tenure at First Chicago to steal inside information about upcoming transactions shortly after his termination. *Id.* at 16-18. Cherif's actions, the court concluded, "betrayed a trust in a way that a mere thief does not" and "were fraudulent in the common understanding of the word because they deprived some person of something of value" by trickery and deceit. *Id.* at 18.[4]

As to Sanchou, the court of appeals believed that further findings were required to determine whether the district court had jurisdiction to enter the preliminary injunction freezing assets held in his name. Pet. App. 23-25. The court indicated the district court would have such jurisdiction, without an allegation that he violated the securities laws, "if it is established that [Sanchou] possesses illegally obtained profits but has no legitimate claim to them." *Id.* at 2 n.11.[5] The court, however, believed that neither the record nor the district court's findings made it clear whether Sanchou has a legitimate claim to the funds in the frozen accounts. *Id.* at 23-24. Accordingly, the court of appeals remanded the case to the district court for an evidentiary hearing regarding petitioners' "respective rights in the accounts." *Id.* at 24-25. Pending the determination of

---

[4] The court of appeals did not address the district court's finding that Cherif also violated Rule 14e-3, 17 C.F.R. 240.14e-3, holding that "a showing that Cherif violated Rule 10b-5 is sufficient to uphold the issuance of the injunction." Pet. App. 20 n.9.

[5] The court also stated that if Sanchou "is himself implicated in Cherif's scheme," the district court must vacate the injunction and the SEC could amend its complaint "to state a claim [under the securities laws] directly against Sanchou to recover the monies held in his accounts." Pet. App. 25.

those issues, the court allowed the preliminary injunction to remain in effect for 14 days. *Id.* at 24.[6]

The court of appeals rejected Sanchou's other challenges to the injunction. Pet. App. 25. The court concluded that Sanchou had waived his challenge to the sufficiency of service of process because Sanchou himself had invoked the jurisdiction of the district court by requesting an order permitting him to pay attorneys' fees from assets frozen by the injunction, and because Sanchou had failed to raise his challenge to service of process at the first available opportunity. *Id.* at 26. The court of appeals also rejected Sanchou's claim that the district court's refusal to modify the freeze order to permit Sanchou to use certain assets to pay legal fees violated his right to counsel. *Id.* at 3-4, 25 n.13, 26-27.

ARGUMENT

1. Petitioner Cherif contends (Pet. 28-47) that the court of appeals erred in finding that the conduct established at the preliminary injunction hearing violates Section 10(b) and Rule 10b-5 based on the misappropriation theory of insider trading liability. He claims that the misappropriation theory is inconsistent with decisions of this Court, and alternatively, that the court of appeals' application of the misappropriation theory on the facts of this case conflicts with decisions of other courts of appeals. Neither contention has merit, and the decision is interlocutory. Review by this Court is therefore not warranted.

a. Under the misappropriation theory, it is a violation of Section 10(b) and Rule 10b-5 for a person

---

[6] The preliminary injunction has continued to remain in effect pending the district court's determination on the issues remanded to it.

to misappropriate material non-public information in breach of a fiduciary duty, and then trade in securities on that information. Pet. App. 10. "There is a common sense notion of fraud behind the misappropriation theory." *Id.* at 15. The theory is premised on the settled principle that a person commits fraud on a source of information when the person acquires or uses information in breach of a fiduciary duty owed to the source. When the stolen information is used to reap profits in securities transactions, the misconduct comes within the scope of Rule 10b-5.

Liability for trading on misappropriated confidential information fits within the language of Section 10(b) and Rule 10b-5. Section 10(b) prohibits the use, "in connection with the purchase or sale of any security," of "any manipulative or deceptive device or contrivance" in violation of rules promulgated by the Commission. 15 U.S.C. 78j(b). Rule 10b-5 prohibits "*any* person" from engaging in "*any* act [or] practice" that "operates or would operate as a fraud or deceit upon *any* person" in connection with the purchase or sale of securities. 17 C.F.R. 240.10b-5 (emphasis added). All of the courts of appeals that have considered the misappropriation theory have agreed that it provides a valid basis for imposing liability under Rule 10b-5. See *SEC* v. *Clark*, 915 F.2d 439, 449-450 (9th Cir. 1990); *SEC* v. *Materia*, 745 F.2d 197, 203 (2d Cir. 1984), cert. denied, 471 U.S. 1053 (1985); *United States* v. *Newman*, 664 F.2d 12, 17 (2d Cir. 1981), cert. denied, 464 U.S. 863 (1983); *Rothberg* v. *Rosenbloom*, 771 F.2d 818, 822 (3d Cir. 1985), cert. denied, 481 U.S. 1017 (1987).[7]

---

[7] As the court of appeals noted, Pet. App. 15 n.5, congressional committee reports on legislation amending the Exchange Act to strengthen its protections against insider trad-

Cherif errs in contending (Pet. 28-29) that the misappropriation theory conflicts with this Court's rejection of a "parity of information requirement" in *Dirks* v. *SEC*, 463 U.S. 646 (1983), and *Chiarella* v. *United States*, 445 U.S. 222 (1980). In those cases, the Court held that a person's failure to disclose material, nonpublic information in a securities transaction does not constitute a fraud on the purchaser or seller absent a duty to speak, and that such a duty arises from a "relationship of trust and confidence between parties to a transaction," not from "mere possession of material nonpublic information." *Chiarella*, 445 U.S. at 230, 235; *Dirks*, 463 U.S. at 654. Neither of those cases, however, considered the misappropriation theory.[5] The misappropriation theory does not impose liability solely on the basis of "mere possession" of material non-public information. The theory applies only when there is a breach of a fiduciary (or similar) duty of trust in the defendant's acquisition or use of information, and it therefore requires that the defendant have committed fraud. Cf. *Carpenter* v. *United States*, 484 U.S. 19, 27

---

ing have also indicated approval of the misappropriation theory. See H.R. Rep. No. 355, 98th Cong., 1st Sess. 5 (1983); H.R. Rep. No. 910, 100th Cong., 2d Sess. 26-27 (1988).

[5] In *Chiarella*, this Court declined to address the misappropriation theory because it was not presented to the jury. 445 U.S. at 236. The four Justices who reached the issue all indicated that misappropriation is a valid basis for liability under Rule 10b-5. *Id.* at 240 (Burger, C.J., dissenting); *id.* at 239 (Brennan, J., concurring in the judgment); *id.* at 245 (Blackmun, J., joined by Marshall, J., dissenting). In *Dirks*, there was no claim that the information had been obtained by misappropriation. *Id.* at 665 (noting that Dirks had not "misappropriate[d] or illegally obtain[ed] the information").

(1987).[9] The misappropriation theory differs from conventional insider trading theory only in that the defendant in a misappropriation case owes a fiduciary duty to the source of the information, while the defendant in a conventional insider trading case owes a fiduciary duty to the issuer and its shareholders. See Pet. App. 12; *SEC* v. *Materia*, 745 F.2d at 201; *United States* v. *Newman*, 664 F.2d at 16; *SEC* v. *Clark*, 915 F.2d at 443; L. Loss, *Fundamentals of Securities Regulation* 867 (1983) (referring to the misappropriation theory as the "breach-of-fiduciary-duty-to-a-third-person theory").

b. Alternatively, Cherif contends (Pet. 28, 37-47) that the "version" of the misappropriation theory adopted by the court of appeals conflicts with the misappropriation decisions of other courts of appeals. No other court of appeals, however, has addressed a scheme comparable to Cherif's. The Seventh Circuit's holding is nevertheless consistent with the rationale of other decisions applying the misappropriation theory, and there is no reason for this Court to re-

---

[9] In *Carpenter*, a reporter used his knowledge of the contents of upcoming columns in his newspaper to trade in the securities of issuers discussed in the columns. The Court unanimously affirmed his mail and wire fraud convictions, and affirmed his securities fraud convictions based on an evenly divided vote. In characterizing the misappropriation theory underlying the securities fraud convictions, the Court noted that the newspaper had "no interest in the securities traded," was not a "market participant," and was "the only alleged victim of the fraud." 484 U.S. at 24. In this case, in contrast, Cherif misappropriated confidential information that First Chicago's customers had entrusted to the bank when considering extraordinary business transactions. Cherif's conduct thus injured not only his former employer, but also his employer's clients, who were "market participants."

view the application of the theory to these unusual facts.

Cherif argues initially (Pet. 37-40) that, even if he breached *some* duty to his former employer, application of the misappropriation theory was improper because there was no "entrustment" of confidential information to him by that employer. Cherif incorrectly states that it is an element of liability under the misappropriation theory that the source of information have entrusted the information to the defendant. No court of appeals has so held. Although many misappropriation cases have involved defendants who were entrusted with confidential information, Cherif errs in stating (Pet. 38) that every misappropriation case has involved that situation. See, *e.g.*, *United States* v. *Grossman*, 843 F.2d 78, 80 (2d Cir. 1988) (attorney obtained confidential information from a casual discussion with law firm colleague who was working on a nonpublic transaction for a client), cert. denied, 488 U.S. 1040 (1989); *SEC* v. *Materia*, *supra* (print shop employee obtained confidential information from draft documents despite efforts by the source of the information to conceal company identities with a code).

An "entrustment" requirement would impose an arbitrary limitation on the types of fraud that are proscribed by Section 10(b) and Rule 10b-5 that is not justified by the language or policies of those provisions. A person who abuses a fiduciary relationship to gain access to confidential information is just as guilty of fraud as one who purloins information that has been entrusted to him. Under Cherif's proposed test, the employee of a company about to make a tender offer who has been entrusted with confidential information would be precluded from trading on such

information, while a colleague who surreptiously learned of the proposed transaction would face no comparable restriction. Cherif offers no reason to draw such an irrational distinction.

Second, Cherif urges (Pet. 40) that he did not breach a fiduciary duty in this case, but simply committed an "illegal unauthorized trespass." The court of appeals, however, correctly characterized Cherif's conduct as the breach of "a continuing duty to his former employer." Pet. App. 17. "Even in the absence of a written contract, an employee has a fiduciary obligation to protect confidential information obtained during the course of his employment." *Snepp* v. *United States*, 444 U.S. 507, 515 n.11 (1980) (per curiam).[10] That common law duty applies to a former employee who acquired confidential information during his tenure. See Restatement (Second) of Agency §§ 395-396 (1958). Indeed, in *Dirks* v. *SEC*, this Court assumed that a former corporate officer was under a duty to refrain from disclosing the confidential information of his former employer for his personal benefit. 463 U.S. at 659, 664. If fiduciary duties did not apply to the use of confidential information by former employees, it would provide a ready avenue for abuse: an employee would only have to quit his job in order to exploit confidential information acquired during his tenure.

Third, Cherif argues (Pet. 41-47) that the knowledge he misused to gain access to the bank was not the sort of confidential information that can form the basis of a breach of fiduciary duty to the bank. Cherif incorrectly states (Pet. 42) that his familiarity with

---

[10] First Chicago's integrity policy also made clear that Cherif was precluded from using confidential information he obtained from the bank for personal gain. See p. 2, *supra*.

the bank's internal security procedures constitutes "general knowledge," the use of which is unconstrained by an employee's fiduciary obligations to his former employer. Cherif's scheme, however, critically depended on use of detailed knowledge regarding First Chicago's internal procedures for maintaining an active identification card and the location within the bank's offices of confidential information regarding nonpublic corporate transactions. Pet. App. 17. Such information is far different from "general knowledge" common to a particular trade or industry. Cherif also asserts (Pet. 46) without any authority that his use of his bank identification card did not breach any duty owed to First Chicago. Use of the card, however, enabled Cherif falsely to pose as an employee of the bank. That deception breached a duty to the bank. See Restatement (Second) of Agency § 386 (1958) ("Unless otherwise agreed, an agent is subject to a duty not to act as such after the termination of his authority."). In sum, by "us[ing] property and information belonging to First Chicago, and made available to him only through his fiduciary relationship," Cherif "betrayed a trust in a way that a mere thief does not." Pet. App. 18.

2. Petitioner Sanchou contends (Pet. 47-51) that the court of appeals exceeded its jurisdiction by allowing the district court's order freezing assets held in Sanchou's name to remain in effect pending further proceedings on remand. He asserts that the court of appeals rejected the jurisdictional theories on which the district court had relied, and therefore was required immediately to vacate the injunction. This interlocutory issue is also fact specific and the court's decision is not in conflict with the decision of any other court of appeals.

Contrary to Sanchou's assertion, the court of appeals did not hold that the district court lacked subject matter jurisdiction over the Commission's claim against Sanchou. Rather, the court indicated that although the SEC had not alleged that Sanchou violated the securities laws, the district court could exercise subject matter jurisdiction over him to reach assets held in his name, provided the SEC establishes that he "has no proper claim to his accounts." Pet. App. 2-3 n.11. The court explained that "[a] court can obtain equitable relief from a non-party against whom no wrongdoing is alleged if it is established that the non-party possesses illegally obtained profits but has no legitimate claim to them." *Ibid.*[11]

It is well settled that a court has subject matter jurisdiction to entertain claims against defendants who did not violate the securities laws, but possess property that is needed to grant complete relief in federal securities actions.[12] In this case, the court

---

[11] The court of appeals did reject the district court's reliance on Fed. R. Civ. P. 19(a) to support jurisdiction, as well as the SEC's argument that the district court had jurisdiction pursuant to Section 21(d) and (e) of the Exchange Act, 15 U.S.C. 78u(d) and (e). Pet. App. 2, 21-22. The Commission disagrees with the court's Exchange Act holding, cf. *Porter* v. *Warner Holding Co.*, 328 U.S. 395 (1946), but the issue is moot in view of the court of appeals' determination that jurisdiction could properly be predicated on other grounds. See Pet. App. 2 n.11 ("Courts have jurisdiction to decide the legitimacy of ownership claims made by non-parties to assets alleged to be proceeds from securities laws violations.").

[12] See *Deckert* v. *Independence Shares Corp.*, 311 U.S. 282, 286, 289 (1940) (holding that the district court had jurisdiction pursuant to jurisdictional provision of Securities Act of 1933, 15 U.S.C. 77v, over claims to recover property held by third-party recipient of proceeds of an allegedly fraudulent securities offering); *SEC* v. *Wencke*, 783 F.2d 829, 833, 836-838 & n.9 (9th Cir.), cert. denied, 479 U.S. 818 (1986); *SEC*

of appeals determined that the propriety of exercising jurisdiction over Sanchou on that theory depends on whether Sanchou has a legitimate ownership interest in the assets held in his name. Pet. App. 2-3 n.11. In order to resolve that question, the court of appeals remanded the case for further factual findings by the district court, and it left the freeze order in effect pending the district court's determination. *Id.* at 24, 26.

Sanchou errs in contending that the court lacked power to continue the freeze while the jurisdictional facts were being determined.[13] This Court has repeatedly noted the distinction between a determination that jurisdiction is lacking and a determination that factual clarification of the basis of jurisdiction is required. The cases on which Sanchou relies in claiming a conflict (Pet. 47-51) involve the former situation; this case involves the latter. When the facts must be clarified to determine jurisdiction, "jurisdiction [is] conferred to make the inquiry and pronounce judgment according to its result." *Vallely* v. *Northern Fire & Marine Insurance Co.*, 254 U.S. 348, 355 (1920); see also *United States* v. *Shipp*, 203 U.S. 563, 573 (1906) (Holmes, J.). Jurisdiction to determine whether subject matter jurisdiction exists carries with it the inherent power "to make orders to

---

v. *Wencke*, 622 F.2d 1363 (9th Cir. 1980); *Tcherepnin* v. *Franz*, 485 F.2d 1251 (7th Cir. 1973), cert. denied, 415 U.S. 918 (1974).

[13] Sanchou also claims in passing (Pet. App. 50 n.6) that the complaint's jurisdictional allegations were defective and that the court erred in allowing them to be cured after an evidentiary hearing. Under 28 U.S.C. 1653, however, "[d]efective allegations of jurisdiction may be amended, upon terms, in the trial or appellate courts." See *Schlesinger* v. *Councilman*, 420 U.S. 738, 744 n.9 (1975).

preserve the existing conditions and the subject of the petition." *Shipp*, 203 U.S. at 573; *United States* v. *United Mineworkers*, 330 U.S. 258, 290 (1947) (court was empowered to issue temporary restraining order pending its decision on whether the Norris-LaGuardia Act divested it of subject matter jurisdiction).

In this case, the court of appeals' continuance of the freeze, while the district court determined the jurisdictional facts, was justified to prevent Sanchou from jeopardizing the Commission's ability to obtain complete relief. The accounts in Sanchou's name contain in excess of $150,000 in profits that derive from Cherif's illegal trading. Pet. App. 8. Moreover, the SEC presented substantial evidence that the funds in those accounts, to the extent that they are not illegal insider trading profits, belonged to Cherif, not Sanchou.[14] Finally, Sanchou attempted to transfer funds out of the United States the day after the court entered the temporary restraining order. Cf. *International Controls Corp.* v. *Vesco*, 490 F.2d 1334, 1354 (2d Cir.) (freeze was proper to prevent dissipation of domestic assets when assets abroad are effectively immunized from execution), cert. denied, 417 U.S. 932 (1974). Under those circumstances, the facts amply warranted the court in continuing the freeze pending the jurisdictional proceedings on remand.

---

[14] The evidence included the fact that exclusive control over the accounts was exercised by Cherif; Cherif told a confederate that he used a Sanchou account to evade federal income taxes; and Cherif used funds in the accounts to purchase property in his own name and to pay off a confederate. Moreover, Sanchou failed to provide an accounting as ordered by the district court, thus justifying the inference that the facts are adverse to his claim. Pet. App. 23; SEC C.A. Br. 11, 45.

3. Sanchou argues (Pet. 57-58) that the Commission was not authorized to serve him with process in Tunisia pursuant to Fed. R. Civ. P. 4(i) and Section 27 of the Exchange Act, 15 U.S.C. 78aa. As Sanchou acknowledges, his challenge to service of process is entirely based on his theory that the district court lacked subject matter jurisdiction over the claim against him. As we have shown, see pp. 13-16, *supra*, Sanchou's jurisdictional argument is flawed, and the validity of service of process on Sanchou presents no additional legal issues.[15]

In any event, the court of appeals concluded that Sanchou waived his challenge to service, Pet. App. 26, and its judgment on that point does not merit review. Whether or not Sanchou's claim was waived under Fed. R. Civ. P. 12(h), see Pet. 58-60, the court of appeals' finding of waiver is justified under the principle that a party who invokes the jurisdiction of the court to obtain relief has submitted itself to that court's jurisdiction. Cf. *Freeman* v. *Bee Machine Co.*, 319 U.S. 448, 453 (1943). That principle applies here because the first motion filed by Sanchou was a motion seeking to modify the preliminary injunction entered by the district court to permit him to use some of the assets to pay his attorneys' fees. Cf. *International Controls Corp.* v. *Vesco*, 490 F.2d at 1353-1354 & n.27 (by filing motion seeking release of seized yacht, Panamanian corporation in whose name yacht was registered gave court personal juris-

[15] Sanchou's statement of the case purports to raise factual questions as to the adequacy of the Commission's proof of service, Pet. 19-21. Those claims, however, raise only fact-bound matters that were rejected by the district court, and the petition contains no argument on them. Accordingly, they do not warrant this Court's attention.

diction over it). Only after he had invoked the jurisdiction of the court did Sanchou raise his challenge to the validity of extraterritorial service of process on him. Pet. App. 26.

4. Sanchou contends (Pet. 52) that the district court's refusal to modify the preliminary injunction, so that he could use some of the funds in accounts frozen by the injunction to pay attorneys' fees, violated his asserted right under the Fifth Amendment to retain counsel. Sanchou, however, failed to establish that he lacked access to other sources of funds that would enable him to retain counsel. There is, therefore, no basis for his asserted due process claim. Cf. *Department of Labor* v. *Triplett*, 494 U.S. 715, 722 (1990) (no showing that the regulation of attorney's fees in a government benefits program infringed due process rights when the record failed to indicate that claimants were denied access to counsel).

The freeze order, by agreement of the SEC, did not apply to Sanchou's funds outside of the United States. The SEC presented evidence that Sanchou has assets of over $600,000 abroad. Although Sanchou made a bare assertion that his funds in Tunisia could not be transferred to the United States, he failed to support that claim with any specific facts, and obstructed examination of it by failing to appear for his deposition and failing to provide an accounting as required by the preliminary injunction. SEC C.A. Br. 14-15 & n.6, 49 n.49. There was no showing that the freeze order imposed any burden on Sanchou's ability to retain legal representation.

Even if the freeze did limit Sanchou's ability to pay an attorney, the order did not infringe his constitutional rights. In *Caplin & Drysdale, Chartered* v. *United States*, 491 U.S. 617, 626 (1989), this

Court held a criminal defendant has no right under the Sixth Amendment to pay an attorney with "money, though in his possession, [that] is not rightfully his." There, the Court upheld a postconviction order forfeiting the proceeds of narcotics offenses under 21 U.S.C. 853(e), even though the order deprived the defendant of funds to pay attorney's fees.[16] In *United States* v. *Monsanto*, 491 U.S. 600, 615 (1989), the Court held that a preconviction freeze of assets is also permissible where there is a finding of probable cause to believe that the assets are forfeitable under Section 853(e) upon conviction; it is not unconstitutional to freeze property "to protect its 'appearance' at trial, and protect the community's interests in full recovery of any ill-gotten gains." 491 U.S. at 616. As the court of appeals noted, Sanchou's Fifth Amendment claim of a right to counsel is weaker than the claims rejected in *Caplin & Drysdale* and *Monsanto*, as there is no explicit constitutional protection of the right to counsel in a civil case. Pet. App. 27.

Whatever Fifth Amendment interest that Sanchou may have to retain counsel in a civil case, "that protection does not go beyond the 'individual's right to spend *his own money* to obtain the advice and assistance of . . . counsel.'" *Caplin & Drysdale*, 491 U.S. at 626 (emphasis added), quoting *Walters* v. *National Ass'n of Radiation Survivors*, 473 U.S. 305,

---

[16] The Court concluded that the Sixth Amendment affords no right to use forfeitable assets to pay attorney's fees, 491 U.S. at 632, and, although expressing doubt that petitioner's reliance on Fifth Amendment "adds anything to [his] Sixth Amendment claim," the Court also found the due process claim to be "unavailing." 491 U.S. at 633.

370 (1985) (Stevens, J., dissenting).[17] There was an adequate showing in the district court that the funds to which Sanchou seeks access are not "his own money."[18] The Commission established an overwhelming "*prima facie* showing," Pet. App. 43, that Cherif violated the securities laws, and the district court found that petitioners failed to establish that any of the proceeds of Cherif's trading, including proceeds held in the Sanchou accounts, are "free from the taint of the securities fraud alleged by the SEC." *Id.* at 46, 44. Profits from illegal insider trading are subject to disgorgement, which in this case would cover $150,000 in the Sanchou accounts. Because the illegal trading profits do not rightfully belong to Sanchou, the court did not err in declining to release those funds from the freeze.

---

[17] Sanchou's reliance (Pet. 56) on *Potashnik* v. *Port City Constr. Co.*, 609 F.2d 1101, 1118 (5th Cir.), cert. denied, 449 U.S. 820 (1980), is misplaced. In that case, the court of appeals held that a court order prohibiting counsel from consulting with a client during breaks and recesses in a trial violated the client's due process rights; there was no claim that the funds sought to pay the attorney were the fruit of illegal activity. Although there was such a claim in *FSLIC* v. *Dixon*, 835 F.2d 554, 564-565 (5th Cir. 1987), see Pet. 52-55, that case was decided before *Monsanto* and *Caplin & Drysdale*, and, as the court of appeals recognized, Pet. App. 4, 26-27, *Dixon*'s reasoning did not survive those decisions. See also *FTC* v. *World Wide Factors, Ltd.*, 882 F.2d 344, 347 (9th Cir. 1989) (relying on *Monsanto* and *Caplin & Drysdale* in rejecting constitutional objections to a freeze order that limited the defendant's assets to pay attorney's fees in a civil proceeding).

[18] In *Monsanto*, this Court did not reach the issue "whether the Due Process Clause requires a hearing before a pretrial restraining order can be imposed." 491 U.S. at 615 n.10. Petitioner does not raise any analogous issue in this case, and, in any event, the court held a hearing before entering the preliminary injunction.

Sanchou also suggests (Pet. 55-56) that he is at least entitled to have the freeze lifted as to the $100,000 that does not represent insider trading profits. At this stage of the litigation, Sanchou has shown no such entitlement. As discussed above, see note 14, *supra*, the Commission presented substantial evidence that the Sanchou accounts, including the $100,000 used to open the securities account, belong not to Sanchou, but to Cherif. By refusing to provide an accounting of those funds, in violation of the district court's order, Sanchou deprived the court of any basis to conclude otherwise, and justified the drawing of adverse inferences. Pet. App. 44, 46. Because the remaining funds, if Cherif is their true owner, could properly be used to satisfy a potential penalty judgment against Cherif, Pet. App. 25 n.13; see also *SEC* v. *Unifund SAL*, 910 F.2d 1028, 1041-1042 (2d Cir. 1990), the court of appeals correctly concluded that the Commission was entitled to freeze them pending further proceedings in this case.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

KENNETH W. STARR
Solicitor General

JAMES R. DOTY
General Counsel

PAUL GONSON
Solicitor

JACOB H. STILLMAN
Associate General Counsel

JOSEPH A. FRANCO
Special Counsel

RANDALL W. QUINN
Senior Counsel

JUDITH R. STARR
Attorney
Securities and Exchange Commission

JANUARY 1992

APPENDIX

UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

---

89 Civ. No. 4204
Judge Norgle

SECURITIES AND EXCHANGE COMMISSION
450 Fifth Street, N.W.
Washington, D.C. 20549
(202) 272-2242, PLAINTIFF

-v-

DANNY O. CHERIF, DEFENDANT

and

KHALED SANCHOU, NOMINAL DEFENDANT

PRELIMINARY INJUNCTION, ORDER FREEZING ASSETS, ORDER FOR AN ACCOUNTING, ORDER PREVENTING ALTERATIONS OR DESTRUCTION OF DOCUMENTS, ORDER MAKING SPECIAL APPOINTMENTS TO SERVE THIS ORDER, ORDER DIRECTING EXTRATERRITORIAL SERVICE OF THIS ORDER AS TO DEFENDANT KHALED SANCHOU; AND ORDER MAINTAINING TEMPORARY RESTRAINING ORDER AS TO DEFENDANT DANNY O. CHERIF

On the Application of Plaintiff Securities and Exchange Commission (the "Commission") for: (1) a

preliminary injunction; (2) an order freezing assets; (3) an order for an accounting; (4) an order preventing alteration or destruction of documents; (5) an order making special appointments to serve this order; and (6) an order directing extraterritorial service of this order; and

Upon consideration of all papers heretofore filed and proceedings had herein, the Court makes the following findings of fact and conclusions of law with respect to Defendant Khaled Sanchou ("Sanchou") and for the purposes of this preliminary injunction:

1. Sánchou is subject to service of process and has been served in accordance with the provisions of the Temporary Restraining Order, including by Airborne Express Mail (International Delivery) and by personal service in Tunisia by an official court bailiff of the judicial circuit of the Tribunal de Premier Instance, Tunis, Tunisia.

2. Sanchou failed to appear for his noticed deposition and failed to provide an accounting as required by the Court's Temporary Restraining Order in this Matter.

3. Sanchou failed to appear at the hearing on the Commission's motion for a preliminary injunction, either personally or through a representative.

4. In view of the foregoing, Sanchou is in default.

5. The evidence presented further shows that a Preliminary Injunction is necessary to prevent irreparable injury to certain public investors and others and is in the public interest.

6. Joinder of Sanchou as a Defendant Pursuant to Federal Rule of Civil Procedure 19 is necessary since, in the absence of such joinder, complete relief cannot be accorded in this action.

7. It further appears from the evidence presented that Sanchou resides in Tunis, Tunisia. The method

of service set forth in Section IV of this Order is the method most likely to comply with the laws of Tunisia and to give effective notice to Sanchou of the Preliminary Injunction.

8. Sanchou, directly or indirectly, has made use of the means and instrumentalities of interstate commerce, of the mails or of the facilities of a national securities exchange in connection with the acts, practices and courses of business described below. Certain of the acts have occurred within the Northern District of Illinois. Accordingly, pursuant to Sections 21(e) and 27(a) of the Exchange Act [15 U.S.C. §§ 78u(e) and 78a(a)], this Court has jurisdiction over the subject matter of this case and over defendant Sanchou, and venue properly lies in this District.

9. Sanchou maintains a securities brokerage account at Quick & Reilly Co. (the "Sanchou Account").

10. The address listed on the Sanchou Account is: care of Danny O. Cherif, 1209 Kenilworth, Aurora, Illinois, 60506.

11. Danny O. Cherif has power to execute trades in the Sanchou Account.

12. The Sanchou Account purchased shares of Consolidated Bathurst in the following amounts at the prices and dates indicated:

(i) January 11, 1989: 2000 shares at $12.75 per share; and

(ii) January 16, 1989: 1000 shares at $12.93 per share;

(iii) January 18, 1989: 2000 shares at $13.25 per share;

(iv) January 18, 1989: 2000 shares at $13.375 per share; and

(v) January 23, 1989: 2000 shares at $13.45 per share.

13. FNBC had material, non-public information concerning the Consolidated Bathurst transactions referenced in the Complaint, prior to January 11, 1989, when the Sanchou Account commenced trading in shares of that issuer.

14. Cherif was issued a machine-readable identification card upon his employment at FNBC; there is no record of his having returned it on his termination in December 1987.

15. FNBC records show Cherif's identification card was used to gain entry to the FNBC premises late on the night of Sunday, January 8, 1989.

16. The Sanchou Account purchased shares of Coleman Industries Inc. in the following accounts at the prices and dates indicated:

(i) February 6, 1989: 2000 shares at $49.375 per share; and

(ii) February 13, 1989: 1000 shares at $47.675 per share.

17. FNBC had material, non-public information concerning the Coleman Industries transactions referenced in the Complaint, prior to February 6, 1989, when the Sanchou Account commenced trading in shares of that issuer.

18. FNBC records show Cherif's identification card was used to gain entry to the FNBC premises late on the night of Sunday, February 5, 1989.

19. The Sanchou Account purchased shares of Payless Cashways Inc. in the following amounts at the prices and dates indicated:

(i) June 1, 1988: 2000 shares at $22.25 per share;

(ii) June 6, 1988: 1000 shares at $22.50 per share;

(iii) June 7, 1988: 1000 shares at $22.25 per share; and

(iv) June 9, 1988: 1500 shares at $23.50 per share.

20. FNBC had material, non-public information concerning the Payless Cashways Inc. transaction referenced in the Complaint, prior to May 31, 1988, when the Sanchou Account commenced trading in shares of that issuer.

21. FNBC records show Cherif's identification card was used to gain entry to the FNBC premises late on the night of Monday, May 30, 1988.

22. The Sanchou Account subsequently sold or tendered shares in the issuers referenced in Paragraphs 13, 17 and 20, above, realizing the following profits and losses:

(i) Consolidated Bathurst Inc.: $67,484.55 profit;

(ii) Coleman Industries, Inc: $60,509.39 profit;

(iii) Payless Cashways Inc.: $21,760.39 profit.

23. Sanchou maintains a securities brokerage account at Shearson.

24. On Monday, May 22, 1989, Sanchou attempted to transfer funds from his Shearson account to a Paris bank.

25. On Monday, May 22, 1989, Sanchou was advised of the entry of this Court's TRO the previous day.

26. Sanchou also tried to transfer assets from his Quick & Reilly account to France on Monday, May 22, 1989, after the TRO was entered.

27. Sanchou renewed his request to Quick & Reilly that his funds be transferred overseas on Tuesday, May 23, 1989.

Therefore, this Court being satisfied that as to Khaled Sanchou the Commission has made a sufficient and proper showing in support of the relief granted herein, as required by Section 21(d) of the Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. § 78u(d)]:

I.

IT IS ORDERED that, pending the final disposition of the Commission's Complaint herein, Sanchou, his officers, agents, servants, employees, attorneys, and those persons in active concert or participation with them who receive actual notice of this Order by personal service or otherwise, and each of them, shall hold and retain within their control, and otherwise prevent any concealment, disposition, transfer or dissipation whatsoever of any assets, funds or other property presently held in their name, for their benefit or under their control or over which they exercise actual or apparent investment or other authority; and each of the financial and brokerage institutions or other persons presently holding such assets, funds or other property shall hold and retain within its control and prohibit the withdrawal, removal, transfer or other disposal of any of the assets, funds or other property presently held in the name, for the benefit or under the control of Sanchou.

II.

IT IS FURTHER ORDERED that, pending the final disposition of the Commission's Complaint herein, Sanchou, his officers, agents, servants, employees, attorneys, and those persons in active concert or participation with them, and each of them, be and hereby are preliminarily enjoined from de-

stroying, mutilating, concealing, altering or disposing of any items, including but not limited to any books, records, documents, contracts, agreements, assignments, obligations or other property of the defendants herein, relating to the defendants or any of their securities, financial or business dealings.

III.

IT IS FURTHER ORDERED that, Sanchou, within three (3) business days of the service of this Order, file with this Court and serve upon the Commission, at the following address: Mark Kreitman, Mail Stop 4-2, Division of Enforcement, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549, an accounting of:

(a) all securities, funds or other assets held in Sanchou's name or in which he has any direct or indirect beneficial interest, from April 1, 1988, to the present, stating the location and disposition of each of such assets;

(b) each account with any financial institution or brokerage firm maintained in his name or in which he has any direct or indirect beneficial interest or over which he exercised actual or apparent control or investment authority, from April 1, 1988, to the present, including, but not limited to each account through which he directed securities transactions at any time since April 1, 1988, or in which proceeds from such transactions were held,

(c) all transactions and the disposition of the proceeds of such transactions in securities

conducted in each account identified in response to subparagraph (b) of this paragraph; and

(d) every transaction from April 1, 1988, to the present in which any funds or other assets of any kind were transferred from either defendant to the other defendant in this action.

IV.

IT IS FURTHER ORDERED that, the Commission shall serve Sanchou in Tunisia personally or by International Express Mail or by Airborne Express Mail (International Delivery) directed to his home or place of business.

V.

IT IS FURTHER ORDERED that, with respect to defendant Cherif, the Court having granted his motion for a continuance of the hearing on the Commission's Motion for a Preliminary Injunction and other relief as to him, the Temporary Restraining Order entered on May 21, 1988, and the Supplemental Order thereto, shall continue in full force and effect until the hearing and determination of the Commission's Motion for a Preliminary Injunction as to Cherif, or such other time as the Court may then order.

/s/ Charles R. Norgle
United States District Judge

DATED: 5/31/89

☆ U. S. GOVERNMENT PRINTING OFFICE: 1991 312324 45219